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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 257.

JAY C. HORMEL,

Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF FOR PETITIONER.

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Pandick Press, Inc., 22 Thames St., New York, U. S. A.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF FOR PETITIONER.

Opinions Below.

The opinion of the United States Board of Tax Appeals (R. 13) is reported in 39 B. T. A. 244. The opinion of the Circuit Court of Appeals (R. 42) is reported in 111 F. (2d) 1.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered April 25, 1940 (R. 50). Petition for writ of certiorari was filed July 19, 1940, and was granted October 14, 1940. The jurisdiction of this Court is conferred by Sec-

tion 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

The petitioner in 1934 created three trusts, identical in terms, each for the benefit of a minor child of petitioner and in each trust declared himself and one Park Dougherty co-trustees of certain property to pay the net income therefrom, up to a certain amount, on receipt, to Germaine D. Hormel, petitioner's wife, as guardian of the child for whose benefit the trust was created. Excess income was to be paid to the grantor. (Such excess income is not involved in this appeal.) Each trust was to terminate at the expiration of three years or upon the earlier death of the taxpayer or the minor child named, whereupon the corpus was to be restored to the grantor or his estate. In a statement accompanying notice of deficiency under the 1934 Revenue Act, the Commissioner cited only Section 166 of that Act, and Article 166-1 of Regulations 86, as amended by T. D. 4629; before the Board of Tax Appeals he relied only on that section and on Section 167 of that Act. Before the Circuit Court of Appeals he abandoned reliance on Section 166 and asserted liability under Section 22 (a) of that Act. The questions are:

1. Was the question of the liability of the petitioner herein under Section 22 (a) of the Revenue Act of 1934 properly before the Circuit Court of Appeals for decision?

2. If the first question be decided adversely to the petitioner herein, did the Circuit Court of Appeals err in holding that upon the facts presented to the Board of Tax Appeals petitioner is liable for taxation in respect of such income under Section 22 (a) of the Revenue Act of 1934?

Statutes and Regulations Involved.

The statutes and regulations involved will be found in the Appendix, *infra,* page 26.

Statement.

Petitioner, a resident of Minnesota, hereinafter referred to as taxpayer, created three irrevocable trusts on July 16, 1934 (R. 30-37) for the benefit of his three minor sons, respectively. He named himself and another, who accepted the trusts, as co-trustees, and conveyed stock of Geo. A. Hormel & Company to said co-trustees. It was provided in each trust that the trustees should receive and hold the securities in trust, collect the dividends and pay the same, when received, up to $2,000 per year to his wife, Germaine D. Hormel, as guardian "for the use and benefit of" her ward, taxpayer's son, and pay the excess, if any, to the taxpayer (R. 30). Each trust was to terminate at the end of three years from date or upon the earlier death of the taxpayer or the son named in the trust. Upon the termination of the trust, the corpus or principal was to belong to the taxpayer, or, in case of his death, to his heirs or the persons named in his will. The co-trustees were given power to appoint proxies to vote the stock held in trust and to exercise voting powers (R. 30). At no time did power exist to revest in the taxpayer as beneficial owner the corpus or principal, or to revoke, alter or amend the trust (R. 31). The guardian or ward was prohibited from encumbering or selling any interest in the trust estate or any dividends therefrom prior to actual receipt. No powers of management resided in the grantor and the trustees' powers were quite limited (R. 30, 31).

In the years 1934 and 1935, all income of the trusts was paid to Gefmaine D. Hormel as guardian, in accordance with the terms thereof and was included in her returns as such (R. 29). The taxpayer did not include said income in his returns (R. 7, 11). Respondent (hereinafter referred to as the "Commissioner") included said dividends in petitioner's gross income and assessed a deficiency, basing his action solely upon Section 166 of the Revenue Act of 1934 (26 U. S. Code, Section 166, 48 Stat. 729) and Article 166-1 of Regulations 86 as amended by T. D. 4629 (R. 8 to 10). We quote as follows from the deficiency statement of the Commissioner:

> "Section 166 of the Revenue Act of 1934 provides:
>
> 'Revocable Trusts.
>
> 'Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—
>
> '(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or
>
> '(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,
>
> then the income of such part of the trust shall be included in computing the net income of the grantor.'
>
> "Since it is the purpose of the Revenue Act of 1934, as provided in section 166, to tax the income to the grantor if at any time in the future the grantor or another not having a substantial adverse interest may, under power specifically vested by the trust instrument, revest title to the corpus of the trust in the grantor, it would seem to follow that the Revenue Act contemplates taxing the income to the

> grantor if, by the express terms of the trust instrument, title to the corpus will certainly revest in the grantor at the end of a comparatively short period'' (R. 8).

Said statement thereupon quotes from and discusses Article 166-1 of Regulations 86 quoted in the Appendix hereto, and then states as follows:

> "In view of the above, it is the opinion of this office that, since you, the grantor, may revest title to the corpus of the trusts in yourself if you survive your wife, and at the end of three years with respect to the trusts for the three sons, they are revocable trusts under section 166 of the Revenue Act of 1934 and article 166-1 of Regulations 86 as amended by Treasury Decision 4629, and the income therefrom is taxable to you'' (R. 10).

The Taxpayer appealed to the Board of Tax Appeals and in proceedings before the Board the facts were stipulated (R. 28 and 29); the stipulation concluded with the following paragraph:

> "For income tax purposes the sole question involved for the Board to decide is whether any or all the items of income set forth in paragraph 7 of this stipulation are taxable to petitioner *as determined by the respondent.*'' (Italics ours.)

It will be observed from the quoted portion of this stipulation that the litigating parties were stipulating the facts solely with reference to Section 166 of the Revenue Act of 1934.

The Commissioner, in the hearing before the Board, relied solely upon Sections 166 and 167 of the Revenue Act of 1934 (R. 44). The Board entered an order on March

28, 1939 eliminating the deficiencies (R. 22), following its decision that neither of said sections was applicable (R. 13-19). The decision by Board Member Murdock (39 B.T.A. 244; R. 13) was reviewed by the full Board (*id.* 248; R. 19). There was a dissent on the ground that the income was taxable under the following quoted portion of Section 167:

> "(a) Where any part of the income of a trust—
>
> * * * * *
>
> (2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor;
>
> * * * * * *
>
> then such part of the income of the trust shall be included in computing the net income of the grantor."

The Commissioner, in his petition for review to the Circuit Court of Appeals, assigned as error the failure of the Board to hold that such income was taxable either under Section 166 or Section 167 (R. 25). No other section of the Act is mentioned in the assignments of error. Although they are six in number, they are, except as stated, of the general nature usually found supporting specific assignments of error.

In his brief before the Circuit Court of Appeals, the Commissioner for the first time injected into the case consideration of Section 22(a) of the Revenue Act of 1934; in said brief he argued that the taxpayer did not give up sufficient interest in the trust income or the trust corpus to avoid taxation under Sections 166, 167 and/or 22(a) of the Revenue Act of 1934, and further that the taxpayer retained sufficient interest in the income and corpus to

justify taxing him under Sections 166, 167 and/or 22(a) considered together and read as a whole (R. 45). The taxpayer, in a supplemental brief, challenged the right of the Commissioner to raise this point for the first time in the Circuit Court of Appeals (R. 47). The Commissioner, in his answering brief, abandoned his contention that Section 166 was applicable and asserted that the income from the trusts was, for purposes of taxation, the income of the taxpayer under Sections 22(a) and 167 (R. 47), and that the Court was not precluded from considering the applicability of Section 22(a).

The Circuit Court of Appeals found that the Board was right in deciding that Section 167 was not applicable to the trusts (R. 47). The Court, however, found on authority of *Helvering* v. *Clifford,* 309 U. S. 331, that the income of the trusts was the income of the taxpayer and the decision of the Board was reversed, the Court stating that

> "the question of the right of this Court to reverse the Board, which decided correctly the only questions expressly presented to it, is not free from doubt" (R. 48).

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

1. In not limiting the issues in the case before it to the questions presented to the Board of Tax Appeals, and in allowing questions of law not presented or passed upon before the Board, to be raised; in particular, allowing the consideration of Section 22 (a) of the Revenue Act of 1934.

2. In reversing the Board of Tax Appeals which decided correctly the only questions presented to it.

3. In holding that the trust income here involved was taxable to petitioner under Section 22 (a) of the Revenue Act of 1934, on the authority of *Helvering* v. *Clifford,* 309 U. S. 331.

Summary of Argument.

We shall contend:

(1) That the income from the trusts is not taxable to the taxpayer under Section 166 of the Revenue Act of 1934, firstly, because this contention was abandoned by the Commissioner before the Circuit Court of Appeals and, secondly, because of the decision of this Court in *Helvering* v. *Wood,* 309 U. S. 344.

(2) That the Circuit Court of Appeals was correct in holding that no income from the trusts is taxable to the taxpayer under Section 167 of the Revenue Act of 1934 because upon the facts stipulated by the parties and found by the Board of Tax Appeals no part of the income from the trusts (other than excess income not involved in the case at bar) could in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition thereof be distributed to the grantor.

(3) That under the rules of appellate practice required by this Court to be followed by Circuit Courts of Appeals in hearing appeals from the Board of Tax Appeals the Commissioner should not have been heard to urge as a ground of reversal of the Board liability of the taxpayer under Section 22 (a) of the Revenue Act of 1934, this question not having been raised either in the deficiency notice of the Commissioner or by the Commissioner before the Board or in his assignments of error on appeal from the

Board to the Circuit Court of Appeals. This rule is not only laid down by this Court for the guidance of the Circuit Courts of Appeals but is enforced by this Court with respect to appeals here and is consistent with the general law on that subject.

(4) That even were the point open for consideration the facts of this case do not bring it within the purview of the decision of this Court in *Helvering* v. *Clifford,* 309 U. S. 331. The facts found by the Board and the provisions of the trusts involved in the two cases differ in vital particulars affecting this question.

POINT I.

The income from the trusts was not taxable to the grantor under Section 166 of the Revenue Act of 1934.

It does not seem necessary to argue this point. As shown above, page 7, although liability was originally predicated by the Commissioner on Section 166 of the Revenue Act of 1934, all contention under this section was abandoned by him in the Circuit Court of Appeals. Furthermore, the decision of this Court in *Helvering* v. *Wood,* 309 U. S. 344, dealing with a similar trust, is conclusive.

POINT II.

The income from the trusts was not taxable to the grantor under Section 167 of the Revenue Act of 1934.

At the time of preparing this brief it is not known whether the Commissioner will endeavor to support the judgment of the Circuit Court of Appeals by invoking Section 167 of the Revenue Act of 1934. It seems clear that

said section is not germane to the problem before this Court. The portion thereof considered by the Court of Appeals reads as follows:

> "(a) Where any part of the income of a trust—
>
> * * * * * *
>
> (2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor;
>
> * * * * * *
>
> then such part of the income of the trust shall be included in computing the net income of the grantor."

It is obvious from the provisions of the trust and a reading of the section that no person specified in the section had any discretion to dispose of the income to the grantor. Section 167 deals not with trusts revocable as to corpus referred to by the Commissioner in his deficiency statement, but solely with the disposition of the income. There can be no question under the wording of the trusts (R. 30, 31) and the stipulation of facts (R. 28, 29) that the income from the trusts up to $2,000 per annum was payable only to the guardian of the minors for their benefit and could not properly have been paid to any one else.

The income of a minor child payable to a guardian must be disposed of by that guardian for the benefit of the child under the powers of visitation of the Court at all times and in all things.

Section 8935, *Mason's Minnesota Statutes*, 1927, Vol. 2, page 1761, provides as follows:

> "Whenever a minor child of a living parent has property sufficient for his maintenance and education in a manner more expensive than such parent

> can reasonably afford, under all the circumstances, the expenses of the education and maintenance of such minor may be defrayed out of his own property, in whole or in part, as shall be deemed reasonable by the court."

This section was amended March 29, 1935 (Laws of Minn., 1935, Chap. 72, Sec. 135, effective July 1, 1935), to read as follows:

> "Guardian's Duties.—A guardian shall be subject to the control and direction of the court at all times and in all things. A general guardian of the person shall have charge of the person of the ward. A general guardian of the estate shall (1) pay the reasonable charges for the support, maintenance, and education of the ward in a manner suitable to his station in life and the value of his estate; *but nothing herein contained shall release parents from obligations imposed by law for the support, maintenance, and education of their children.*" (Italics ours.)

There is nothing in the record which would lend support to a contention that the trusts were established to discharge the taxpayer's legal obligation to support his children. In the case at bar the Circuit Court of Appeals decided the question of liability under Section 167 favorably to the taxpayer (111 F. (2d) at page 4; R. 47). Its reasoning, we submit, is unassailable. We cannot believe that the Commissioner will seriously urge any contention under this section. In *Helvering* v. *Wood,* 309 U. S. 344, which involved a trust similar in many cardinal features to those in this case, the Commissioner expressly abandoned all contention under Section 167 in the Circuit Court of Appeals and made no attempt to assert liability thereunder before this Court.

POINT III.

The Commissioner's contention that this case is governed by Section 22 (a) of the Revenue Act of 1934 should not have been considered or passed upon by the Circuit Court of Appeals.

As we have shown above, the Commissioner, representing one of the great departments of the government, assessed a deficiency against the grantor solely upon the authority of Section 166. We refer again to the statements of the Commissioner appearing in the Record, pages 8 and 10, quoted pp. 4, 5, *supra*.

This case was tried before the Board entirely upon stipulation. Stipulations often serve the useful function of waiving contentions or eliminating issues. This stipulation concludes with the following words:

> "For income tax purposes the sole question involved for the Board to decide is whether any or all the items of income set forth in paragraph 7 of this stipulation are taxable to petitioner *as determined by the respondent*" (R. 29). (Italics ours.)

This provision was drafted by the Commissioner's office. Ordinary canons of construction as well as common sense require that all of the wording of a provision which has been carefully drafted by counsel should be given effect. Unless the words "*as determined by the respondent*" are to be left without any meaning they must be given the connotation for which we contend, to wit: that the issues were limited to determining whether the income was taxable to the petitioner upon the grounds set forth by the Commissioner in his deficiency statement. If it had been

intended that he could at any stage of the litigation, on trial or on appeal, raise any issue occurring to him there would have been no point in including the italicized words.

The Commissioner's contention, upon which he has heretofore leaned so heavily in this and other litigations, that by referring in his statement to Article 166-1 of Treasury Regulations 86 he in effect called to taxpayer's attention Section 22 (a) is, we submit, with all deference, both specious and disingenuous. The regulation was not propounded under Section 22 (a); it was propounded under Section 166 and, as appears from the introductory statement to the Regulations, it was applicable only to Section 166.* The Commissioner's statement dealt only with Section 166. Before the Board he never mentioned Section 22 (a). How then can he assert that there was at any time prior to the filing of his brief in the Circuit Court of Appeals any *bona fide* intention on his part to rely on, litigate or assert liability under Section 22 (a)? The Commissioner's position more candidly stated is that notwithstanding his failure to litigate the question below he can as a matter of right litigate the question above. Such is the

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* We quote as follows from page III of the introductory statement to Treasury Regulations 86:

> "The plan has been adopted of using the numbers of the sections of the Act as key numbers, followed by a dash (—), with the number of the article placed after the dash. By this means anyone who desires to learn how a given section or subsection of the Act has been interpreted by the Bureau can readily and quickly find that interpretation by using the key number. Thus, if one desires to learn what interpretation has been placed on section 26 of the Act, he should turn to article 26—1 of the regulations."

Article 166—1 contains no reference to Section 22(a) or the regulations thereunder and those regulations, although containing numerous cross references to related provisions of the 1934 Act and of Regulations 86, make no reference to Section 166 or Article 166—1.

issue now tendered and the *only* issue now tendered. It is submitted that under the well settled practice of this Court, both in its instructions to the Circuit Courts of Appeals for the hearing of appeals from the Board and in its consideration of questions presented to this Court, the Commissioner was foreclosed from seeking reversal of the Board because of alleged liability of the taxpayer under Section 22 (a).

In *General Utilities & Operating Company* v. *Helvering*, 296 U. S. 200, it appeared that the Board of Tax Appeals had set aside a deficiency in income tax made by the Commissioner against the General Utilities & Operating Company (29 B. T. A. 934). On appeal to the Circuit Court of Appeals two grounds for reversal were urged by the Commissioner. On the first ground the Circuit Court of Appeals sustained the Board. The second point raised by the petitioner had not been urged before the Board and as to this the Circuit Court of Appeals in its opinion states, 74 F. (2d) 972, at page 975:

> "As to the second point raised by the petitioner, it is contended on behalf of the respondent that this point, not having been raised before the Board, cannot now be urged before us for the first time. We cannot agree with this conclusion."

Thereupon the Circuit Court of Appeals reversed the Board upon the second point and remanded the case.

When the case came here, Mr. Justice McReynolds, speaking for a unanimous court, said (296 U. S. at pp. 206, 207):

> "The second ground of objection, although sustained by the court, was not presented to or ruled upon by the Board. The petition for review relied

wholly upon the first point; and, in the circumstances, we think the court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised.

* * * * * *

Here the court undertook to decide a question not properly raised. Also it made an inference of fact directly in conflict with the stipulation of the parties and the findings, for which we think the record affords no support whatever. To remand the cause for further findings would be futile. The Board could not properly find anything which would assist the Commissioner's cause."

Very shortly thereafter this Court had before it the same problem in *Helvering* v. *Salvage,* 297 U. S. 106. In that case the taxpayer appealed to the Circuit Court of Appeals from an adverse ruling of the Board. The Court of Appeals, 76 F. (2d) 112, reversed such decision and in so doing took under consideration the Commissioner's defense of estoppel, not asserted below. On this point the Court of Appeals agreed with the taxpayer and found there was no estoppel. Nevertheless, this Court criticized the practice of giving consideration to a point not raised before the Board. We quote from the opinion, 297 U. S. 106 at p. 109:

"The defense of estoppel was not before the Board. Under what we regard as the correct practice, *General Utilities & Operating Co.* v. *Helvering,* 296 U. S. 200, the court should have passed the point. Furthermore, the facts disclosed give it no support."

In applying the similar rule which obtains in this Court as to points not raised in the Board or the Circuit Court of Appeals, Mr. Justice Stone, speaking for the Court in *Blair, Commissioner* v. *Oesterlein Co.*, 275 U. S. 220, 225, stated that "there are specially cogent reasons why this rule should be adhered to when the question involves a practice of one of the great departments of the Government."

Where a department of the Government after due consideration notifies a taxpayer that by reason of certain provisions of the law he has incurred liability to the Government, what is the taxpayer to do? Is he to scan the revenue acts for every possible section under which liability could be asserted and then seek to convince the Commissioner that he is not liable under any of them—notwithstanding that the Commissioner has only asserted liability under one of them? Again, when the Commissioner has overruled the taxpayer's objections and the taxpayer has petitioned the Board of Tax Appeals to consider the point, is the taxpayer to be called upon to file an encyclopedic brief before the Board and to raise questions of possible liability that have not been asserted by the Commissioner? Yet, in effect this is the practice for which the respondent is contending. He is contending in effect that after he has had his day in the court below and has lost the case he may for the first time on appeal assert grounds of liability never before asserted in the case, never before considered by the taxpayer or by the Board of Tax Appeals and seek reversal and win his victory as the result of an afterthought disclosed by the weakness of his case as litigated.

It is pertinent to observe that the rule of appellate practice which this Court has laid down for the Circuit Courts of Appeals is applied by it to appeals heard here

where the point was not raised in the Circuit Court of Appeals.

Helvering v. *Wood*, 309 U. S. 344;
Burnet v. *Commonwealth Improvement Co.*, 287 U. S. 415, 418;
Helvering v. *Tex-Penn Oil Co.*, 300 U. S. 481;
Helvering v. *Minnesota Tea Co.*, 296 U. S. 378.

A succinct statement of the fundamental reasons underlying this rule of practice is to be found in *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481, at page 498:

> "The taxpayers were entitled to know the basis of law and facts on which the Commissioner sought to sustain the deficiencies. His failure earlier to present the question leaves this Court without the assistance of decision below."

It is not without interest that the Circuit Courts of Appeals have almost invariably followed this rule of practice in appeals from the Board of Tax Appeals.*

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* *Helvering* v. *Achelis*, 112 F. (2d) 929 (C. C. A. 2);
Loeb v. *Commissioner*, 113 F. (2d) 664 (C. C. A. 2);
Pfeiffer v. *Commissioner*, 88 F. (2d) 3 (C. C. A. 2).
But see *Commissioner* v. *Berolzheimer* (C. C. A. 2) decided December 23, 1940 (not officially reported);
Kraft v. *Commissioner*, 111 F. (2d) 370 (C. C. A. 3);
Philips v. *Commissioner*, 112 F. (2d) 721 (C. C. A. 3);
Commissioner v. *Richter*, 114 F. (2d) 452 (C. C. A. 3), now before this Court No. 516;
Groves v. *Commissioner*, 99 F. (2d) 179 (C. C. A. 4);
Rhodes v. *Commissioner*, 111 F. (2d) 53 (C. C. A. 4).
But see *Legg's Estate* v. *Commissioner*, 114 F. (2d) 760 (C. C. A. 4);
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Schoenfeld v. *Commissioner*, 103 F. (2d) 964 (C. C. A. 9).

This is, of course, a general rule of appellate practice. *Virtue* v. *Creamery Package Co.*, 227 U. S. 8, 38. As this Court observed in *Blair* v. *Oesterlein Co.*, 275 U. S. 220, 225:

> "We think the question suggested is not properly before us. It was not specifically raised on the record before the Board or either court below and, so far as appears, was not considered by any of them. We were asked to grant certiorari only to pass upon the question whether the Commissioner's determinations under §§327 and 328 may be appealed to the Board of Tax Appeals. This Court sits as a court of review. It is only in exceptional cases, and then only in cases from the federal courts, that questions not pressed or passed upon below are considered here. *Duignan* v. *United States*, 274 U. S. 195. There are specially cogent reasons why this rule should be adhered to when the question involves a practice of one of the great departments of the government."

Let us consider for a moment the reason given by the Circuit Court of Appeals in this case for departing from this well-established rule. At the outset of its discussion of the point the Circuit Court states (111 F. (2d) at p. 5; R. 48) that the question of its right to reverse the Board on such a point "is not free from doubt". It then finds that this is an exceptional case which justifies it in departing from the rule. What are the exceptional circumstances? They boil down to this: that while the appeal was pending this Court found adversely to a taxpayer in *Helvering* v. *Clifford*, 309 U. S. 331, in which case was involved a trust indenture bearing certain similarities to the trusts in this case. Let us assume for the moment that the facts in this case are on all fours with the facts in the *Clifford* case and that had the point been presented to the Board this Court

would be of the opinion that the Board should impose liability upon the taxpayer. Why should that change the rule of appellate practice? In the *Clifford* case the question was presented squarely to the Board and both the Board and the taxpayer had full opportunity to consider, discuss and litigate the issue. The record on appeal in the *Clifford* case shows that the taxpayer's petition to the Board was filed on May 13, 1937 and the answer of the Commissioner was filed on July 9, 1937. The hearing therein was held on June 20, 1938 and on September 27, 1938 the Board entered its decision favorable to the Commissioner. Can it be said that in the case at bar which was heard by the Board of Tax Appeals on June 27, 1938 (R. 1), one week after the hearing in the *Clifford* case, the Commissioner was unaware of arguments which he presented to the Board of Tax Appeals in the *Clifford* case and which was decided by the Board in that case favorably to him in the same year? In the opinion of the Board in the *Clifford* case it is stated that the retained interest and powers of the taxpayer were so substantial that the securities may be properly regarded as his property and the Board closed its opinion by stating

> "We need not discuss respondent's further contentions that petitioner is also taxable under the provisions of Sections 166, or 167, Revenue Act of 1934 or under the 'family maintenance' doctrine." (Record in *Clifford* case, p. 16.)

Here then we have the Commissioner in the *Clifford* case successfully asserting liability against the taxpayer under Section 22(a) of the Revenue Act of 1934. During the same year and almost at the same time a hearing in the case at bar is held, and in this case no liability is asserted

except under Section 166 and Section 167. Even then the Commissioner did not assert error on appeal to the Circuit Court of Appeals predicated on Section 22 (a).* Urgent as may be the needs of the Government for revenue we do not believe that its needs are so pressing that it should ask the court to sanction practice such as this. As this Court observed in the *Wood* case after citing *Burnet v. Commonwealth Improvement Co.*, 287 U. S. 415:

> "It is not apparent why a less strict rule is necessary in order adequately to protect the revenue" (309 U. S. at p. 349).

POINT IV.

Even were the point available for consideration, Section 22 (a) of the Revenue Act of 1934 does not render the income of the trusts in this case taxable to petitioner.

Section 22 (a) so far as pertinent reads as follows:

> "Sec. 22. Gross Income
>
> (a) General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or

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* The stringent rule of the Circuit Court of Appeals for the 8th Circuit that it will not consider points not covered by specific assignments of error is found in *Krause v. Snyder*, 87 F. (2d) 723, 725 (C. C. A. 8th). Under its own rule regarding assignments of error the court should not have considered any argument based on Section 22 (a).

> interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever * * *" (U. S. C., Title 26, Sec. 22).

As we have set forth in Point III above, it is our contention that the instant case does not involve the question of taxability of these trusts under Section 22 (a). But even were the point here for decision, we believe that the Commissioner's argument would fail and that the decision of the Circuit Court of Appeals should be reversed. It is submitted that the Court below misapplied the rule set forth in *Helvering* v. *Clifford*, 309 U. S. 331, inasmuch as there are many fundamental differences between the case at bar and the *Clifford* case. It might be called to the Court's attention that the Board of Tax Appeals, the triers of fact in the *Clifford* case, found specifically that the husband, taxpayer, was the owner of the corpus for the purposes of Section 22 (a). This Court there stated:

> "Thus, where, as in this case, the benefits directly or indirectly retained blend so imperceptibly with the normal concepts of full ownership, we cannot say that the triers of fact committed reversible error when they found that the husband was the owner of the corpus for the purposes of Section 22 (a)" (p. 336).

Again, at a later point, the Court stated:

> "The failure of Congress to adopt any such rule of thumb for that type of trust must be taken to do no more than to leave to the triers of fact the initial determination of whether or not on the facts of each case the grantor remains the owner for purposes of Section 22 (a)" (p. 338).

In other words, we start out with the premise of not disturbing a decision by the triers of fact. The triers of fact in this case found adversely to the Commissioner on the only issues presented to them by the litigants.

The courts have recognized in general that the grantor of a trust may be the owner in substance of the income of a trust by virtue of his unfettered command of the corpus or income and the use of the income by the grantor to satisfy his obligations. At no point before the Board of Tax Appeals was this contended for, as can be seen by the findings of the Board (R. 16 and R. 18) and at no time did the Commissioner contend that the trusts were lacking in substance (R. 18).

There are vital points of distinction between the trusts in the two cases:

(1) In the *Clifford* case the grantor was sole trustee. Here the grantor and another were co-trustees. As co-trustees they must act jointly in dealing with the trust estate. This limits the power and control of the grantor in the instant trusts.

See *Scott on Trusts*, Section 194:

> "Where there are two or more trustees, it is essential that they all concur in the exercise of the powers conferred upon them."

American Law Institute Restatement of the Law of Trusts, Section 194:

> "If there are two or more trustees, action by all of them is necessary to the exercise of the powers conferred upon them as trustees. If one of them refuses to concur in the exercise of a power, the others cannot exercise the power. In such a case,

however, if it appears to be for the best interest of the trust that there should be an exercise of the power, the court may on the application of a co-trustee or beneficiary direct its exercise."

See also

Winslow v. *Baltimore & Ohio Railway Co.*, 188 U. S. 646;
Morville, Jr. v. *Fowle*, 10 N. E. 766, 768 (Mass.);
Perry on Trusts and Trustees, 7th Edition, paragraphs 411 and 412.

(2) The trust in the *Clifford* case authorized the sale, exchange, mortgage, and pledge of trust property in the absolute discretion of the grantor of the trust. There were no such unusual powers granted in the case at bar.

(3) In the Clifford trust the grantor trustee had power to invest and reinvest corpus and income without restriction, to compromise claims, to hold stock in the trustee's name as an individual. No such powers are in the Hormel trusts.

(4) The Clifford trust authorized accumulation of income. The Hormel trusts require the payment to the beneficiaries of the income on receipt (R. 33), and this was done (R. 29).

(5) The income in the Clifford trust was subject to disposition by Mrs. Clifford, the wife of grantor. In the Hormel trusts the income goes to a guardian subject to visitation by the court (*supra*, pp. 10, 11). And in a trust such as this, even the sale of the trust *res* would be subject to visitation by the Minnesota District Court. See Section

8100-1 *Mason's Minnesota Statutes* 1927, Vol. 2, p. 1622 (Appendix, p. 30); *Mayall* v. *Mayall,* 63 Minn. 511, 65 N. W. 942.

Is it not fairly to be inferred that the triers of fact in this case, since they decided favorably to the taxpayer, reaching a conclusion contrary to that which they contemporaneously reached in the *Clifford* case, were impressed by the differences above pointed out? This Court has indicated in its decision in the *Clifford* case that there is "no rule of thumb" to serve as a guide for all cases, and we submit it has also indicated that the large shadowland not covered by specific statutory mandate constitutes a field for exploration by those whose duty it is to determine the facts of the case. Occasional nice distinctions may have to be drawn and cases will be found on both sides of the line, albeit very close to it. We take it that this Court in deciding the *Clifford* case has not assumed the tremendous burden of deciding on which side of that line all tax cases involving term trusts are to be placed, but has rather announced general principles for the guidance of the courts below, leaving the analysis of the facts of each case to them. If we have not misapprehended the principles laid down by this Court in the *Clifford* case then it must follow that this Court, as in the *Clifford* case, will respect the decision of the Board on the only issues presented to it.

To construe the Revenue Act as requiring the taxation to the grantor of the income from trusts such as those in the case at bar, notwithstanding the findings of the Board, might render doubtful the constitutionality of such legislation under the decision of this Court in *Hoeper* v. *Tax Commission of Wisconsin,* 284 U. S. 206.

Conclusion.

It is respectfully submitted that the judgment of the court below should be reversed, and the order of the Board of Tax Appeals reinstated.

January, 1941.

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Appendix.

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, or whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (U. S. C., Title 26, Sec. 22.)

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor. (U. S. C., Title 26, Sec. 166.)

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest

in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 166-1 [as amended by T. D. 4629, XV-1 Cum. Bull. 140, 141 (1936), and T. D. 4759, 1937-2 Cum. Bull. 117, 118]. *Trusts, with respect to the corpus of which, the grantor is regarded as remaining in substance the owner.*—(*a*) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor. This

article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(*b*) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period

to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in order to conserve the property, not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

(*c*) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of owner-

ship with respect to the income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

(*d*) If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

If the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom. If the power to revest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.

Section 8100-1, Mason's Minnesota Statutes, 1927, Vol. 2, page 1622:

"Sale, mortgage, pledge, lease, etc., of property held in trust created by written instrument—Sales, etc., void, when—Authority of district court to order

sale, etc.—When any trust is expressed in the instrument creating the trust estate, every sale, conveyance, or other act of the trustee in contravention of the trust shall be absolutely void, except as in this act provided. The district court of the county wherein the property, whether real or personal, or any part thereof, held in trust is situate may, by order, on such terms and conditions as seem just and proper, authorize any such trustee, whether he be beneficially interested in such trust property or not, to sell or otherwise dispose of, mortgage or pledge all or any part of such trust property, whether real or personal, whenever it appears to the satisfaction of the court that it is necessary, or for the best interest, or for the benefit of the trust estate, or of the person or persons beneficially interested therein holding the first and present estate, interest or use, and that it will do no substantial injury to the heirs or next of kin, or others in succession, expectancy, reversion or remainder, in respect of such property."

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